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No. 91-1120

Supreme Court, U.S.
FILED
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IN THE

Supreme Court of the United States

OCTOBER TERM, 1991

ASSOCIATES IN ADOLESCENT PSYCHIATRY, S.C., MARVIN J. SCHWARZ and JOANNE G. SCHWARZ, Trustees of the Defined Benefit & Contribution Pension Plans and Trusts of Associates in Adolescent Psychiatry, S.C. and all Beneficiaries and Participants Thereunder,

Petitioners,

v.

HOME LIFE INSURANCE COMPANY OF NEW YORK, a New York Corporation, Individually and d/b/a Qualified Pension/Profit Sharing Consultants, Inc.; HOSPITAL TRUST NATIONAL BANK, a National Banking Association; CANAPARY FINANCIAL CORP., a Corporation; ROBERT CANAPARY, Individually and d/b/a Qualified Pension/Profit Sharing Consultants, Inc.; RONALD AURE, Individually and d/b/a Qualified Pension/Profit Sharing Consultants, Inc.; PENSION ACTUARIES, INC., a Corporation; ERIC KRANKE; LEVENFELD, KANTER, BASKES AND LIPPITZ, a Partnership; and JERRY BIEDERMAN,

Respondents.

On Petition for Writ of Certiorari to the United States Court of Appeals for the Seventh Circuit

RESPONDENT HOME LIFE INSURANCE COMPANY'S BRIEF IN OPPOSITION

JOSEPH J. HASMAN
Counsel of Record
PETERSON & ROSS
200 East Randolph Drive
Suite 7300
Chicago, Illinois 60601
(312) 861-1400

Attorney for Respondent
HOME LIFE INSURANCE
COMPANY OF NEW YORK

Of Counsel:
ERNEST W. IRONS
PETERSON & ROSS
200 East Randolph Drive
Suite 7300
Chicago, Illinois 60601
(312) 861-1400

Midwest Law Printing Co., Chicago 60611, (312) 321-0220

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QUESTIONS PRESENTED

This case involves the application of the federal securities laws and ERISA to a pension plan's purchase of a flexible premium annuity contract from a state-regulated insurance company. The courts below, on their review of the undisputed facts, held that the "Flexible Annuity" contract at issue was not a security. The courts further held that the "Flexible Annuity" contract itself, and not the contributions paid to the insurer, was the asset held by the pension plan, and that the pension plan's claims of ERISA fiduciary breach did not arise out of any exercise of the insurer's discretionary powers with respect to that asset. The two questions presented are:

I.

Whether the insurance exemption from securities regulation of §3(a)(8) of the Securities Act of 1933 applies to a flexible premium annuity contract which guarantees principal and accumulated interest; guarantees a minimum 4% annual interest rate; declares excess dividend interest in advance and does not alter that excess interest for at least one year; and is issued by a state-regulated insurance company.

II.

Whether a flexible premium annuity: issued by, and backed by all the assets of, a state-regulated insurer; which guarantees principal and accumulated interest; guarantees a minimum 4% interest rate and declares excess dividend interest rates in advance and does not alter them; is a "guaranteed benefit policy" under ERISA §401(b)(2)(B).

PARTIES

In compliance with Rule 29.1, respondent, Home Life Insurance Company of New York, states that it is a mutual insurance company and has no parent or subsidiary companies within the meaning of Rule 29.1.

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RESPONDENT HOME LIFE INSURANCE COMPANY'S BRIEF IN OPPOSITION

STATEMENT OF THE CASE

In 1977, petitioner Associates in Adolescent Psychiatry, S.C. ("AAP"), as plan sponsor, established a defined benefit pension plan naming AAP as plan administrator, and petitioners Marvin J. Schwarz and Joanne G. Schwarz as trustees and investment managers. At the time, AAP already sponsored a defined contribution pension plan which named Marvin J. Schwarz as trustee.[1] To fund the pension plans, the trustees purchased from respondent, Home Life Insurance Company ("Home Life"), a whole life insurance policy and a flexible premium annuity contract called the "Flexible Annuity."[2] The contributions made to the Flexible Annuity by the pension plans were, as required by New York insurance law, deposited in Home Life's general account and commingled with all of Home Life's corporate assets, including premiums and contributions paid by policyholders for other non-pension insurance products.[3] The Flexible Annuity, as well as all of Home Life's general account insurance policies, was backed by all of Home Life's assets.[4] The Flexible Annuity guarantees principal and accumulated interest and a minimum 4% annual rate of return. In addition, Home Life declared, in advance, an annual excess dividend interest rate on

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[1] Uncontested Facts 1-3, 72-74. (The parties' exhibit list and a statement of Uncontested Facts were submitted to the District Court in a Final Pretrial Order on February 3, 1987.)

[2] Uncontested Fact 88.

[3] 729 F. Supp. at 1169, 1186.

[4] 729 F. Supp. at 1175.

existing deposits, which rate was never altered more frequently than once per year.[5]

Wishing to sell the Flexible Annuity nationwide, but desiring to avoid the time delays attendant to submitting the product for regulatory approval in every state on an individual basis, Home Life had structured the Flexible Annuity as a group annuity product. Home Life first sought regulatory approval in New York, its State of domicile, but due to the then-restrictive New York laws concerning the definition of a "group," Home Life filed and obtained approval of the Flexible Annuity in the State of Rhode Island. The Flexible Annuity was sold through a trust established at the Hospital Trust National Bank of Rhode Island to which Home Life issued the group annuity contract.[6]

The AAP pension plan made payments under the terms of the Home Life products until 1980. During this time, the return on Home Life's entire portfolio of assets (which was invested long-term) lagged behind the returns available from short-term investments prevailing in the skyrocketing interest rate environment of the early 1980s. Exhibiting buyer's remorse, the petitioners brought this action, originally alleging ERISA violations and subsequently adding securities fraud and RICO counts.[7] The district court granted summary judgment on all counts, first holding that the Flexible Annuity was not a security and was a guaranteed benefit policy (729 F. Supp. 1162) and subsequently holding that no predicate acts of fraud

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[5] Uncontested Fact 145, Joint Trial Exhibit 489.

[6] Uncontested Facts 10, 169-171; Plaintiffs' Exhibit 35.

[7] 941 F.2d at 565.

existed for purposes of the RICO counts (751 F. Supp. 727). The court of appeals affirmed (941 F.2d 561).[8]

The mail and wire fraud allegations, on which the Court of Appeals affirmed summary judgment, were essentially identical to the allegations of fraud and misrepresentation underlying the ERISA and securities fraud counts. Petitioners have not sought review of the Court of Appeals affirmance of summary judgment on the RICO claims.

REASONS FOR DENYING THE WRIT

INTRODUCTION

The petition for writ of certiorari continues petitioners' approach to this case of ever so subtly misstating and mischaracterizing the facts, and mischaracterizing what the lower courts in this case, and the decisions those courts relied on, found and held. Based on the uncontested material facts in the record, the Flexible Annuity is a garden variety insurance company annuity contract and is entitled to the insurance exemption in Section 3(a)(8) of the Securities Act of 1933. It is also appropriately described as a "guaranteed benefit policy" within the meaning of Section 401(b)(2) of the Employee Retirement Income Security Act ("ERISA") 29 U.S.C. §1101(b)(2). The decisions of the trial court and Circuit Court of Appeals carefully and correctly applied existing precedent. They break no new legal ground, and are not in conflict with

[8] At the time the petition for writ of certiorari was filed, apparently the Circuit Court of Appeal's opinion had not yet been published.

the decisions of this Court or any other Circuit Court of Appeals. The Seventh Circuit's decision was correct, and the writ should be denied.

A.

THE FLEXIBLE ANNUITY CONTRACT IS NOT A SECURITY.

Section (2)(1) of the 1933 Act (15 U.S.C §77(b)(1)) establishes the definition of the term "security" for the purposes of the statute. Under *SEC v. Variable Annuity Life Ins. Co.*, 359 U.S. 65 (1959) ("VALIC") and *SEC v. United Benefit Life Ins. Co.*, 387 U.S. 202 (1967) ("United Benefit") whenever a contract satisfies the definition of "annuity contract," contained in the exemption found in Section 3(a)(8) of the 1933 Act (15 U.S.C. §77(c)(a)(8)), the contract is not a security. This makes good sense because, as Justice Brennan observed in his concurring opinion in *VALIC*, there "was a form of 'investment' known as insurance (*including 'annuity contracts'*) which did not present very squarely the sort of problems that the Securities Acts . . . were devised to deal with, and which were in many details, subject to a form of state regulation of a sort which made the federal regulation even less relevant." (Emphasis added) *VALIC* at 75.

In concluding that the Flexible Annuity was entitled to the Section 3(a)(8) exemption the Seventh Circuit carefully analyzed, and its opinion is totally consistent with, the opinion of this Court in *United Benefit*. Unlike the Home Life Flexible Annuity which guarantees principal and accumulated interest, a minimum 4% interest return, and an excess dividend interest declared in advance, the minimum guarantee in *United Benefit* extended solely to the cash value of the contract holder's net premiums (principal). 387 U.S. at

205. Though the *United Benefit* contract holder was entitled to his proportionate share of the total investment fund, there was no guarantee that any earnings would accrue to the contract holder as a result of fund investment experience.

Petitioner's factual contentions concerning a conflict with *United Benefit* are simply untrue. The Flexible Annuity itself and the sales brochure received by petitioners[9] stated that the excess dividend interest rate would be declared annually by Home Life's Board of Directors at the beginning of each year. Yet, even in the face of the Seventh Circuit's clear factual findings to the contrary (941 F.2d at 567), petitioners argue that Home Life retained the right to alter interest rates at its discretion. Petitioners cite to PLX 52 (R. 422-1) as evidence of this contention. Petitioners fail to advise the Court that this document was created on November 19, 1979 and that, by the end of 1979, the 1980 declared interest rate for all of 1980: was unequivocally shown by separate letter dated December 31, 1979; was distributed to all Flexible Annuity contract holders; and was never modified. There is no evidence that that rate was "reconsidered" following "declaration" by communicating it to the contract holders. Petitioners further persist in confusing the distinction between dividend interest rates declared for existing deposits, and those declared prospectively for contribu-

[9] The trial court made a factual finding that the sales brochure, read as a whole, did not promote the Flexible Annuity primarily as an investment. Rather, the brochure repeatedly stressed that the Flexible Annuity was a method of saving for retirement with guaranteed principal, guaranteed interest, and a guaranteed life income. 729 F. Supp. at 1174.

tions which the pension plans might or might not make in the future.[10]

Finally, contrary to petitioner's erroneous contentions, and as the Seventh Circuit found, Home Life is regulated in many states, including its domiciliary state of New York and the Flexible Annuity was filed with the Rhode Island Department of Insurance. Home Life did not go to Rhode Island because of any objection to the Flexible Annuity policy form by the New York Insurance Department, or to avoid State insurance regulation, but because, at the time, New York insurance law would not recognize a "group" consisting of individuals who wanted to establish Individual Retirement Accounts and who did not have a common employer. Furthermore, the Flexible Annuity certificates were filed with the New York Insurance Department.[11]

Petitioner's arguments here merely rehash arguments made and rejected by both the trial court and the Seventh Circuit. The trial court and the Seventh Circuit, based upon their review of the undisputed facts, properly concluded that the Flexible Annuity met the §3(a)(8) exemption, and entered and affirmed summary judgment on the federal securities law claims.

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[10] In adopting Rule 151 (17 C.F.R. 231.151) (a safe harbor for certain annuity contracts) the SEC has specifically approved differing first year rates for deposits made at different times during that first year. *See* FED. SEC. L. REP. 84,004 at 88,134-35. The Seventh Circuit acknowledged that Rule 151 might facilitate understanding of the statutory law, but because the flexible annuities were developed and sold to the pension plans prior to the issuance of the rule, it did not affect the disposition of the case which was decided under §3(a)(8). 941 F.2d at 565. Petitioners' reference to ERISA §404(a)(1)(D) is misplaced and irrelevant.

[11] R. 350-2, Exh. C.

B.

HOME LIFE HAD LIMITED FIDUCIARY OBLIGATIONS AND DID NOT BREACH THEM.

The Seventh Circuit correctly concluded that the Flexible Annuity was a "guaranteed benefit policy" within the meaning of ERISA; that therefore the insurance contract itself was the asset held by the pension plans; and that Home Life had not violated any fiduciary obligations it might have with respect to any discretion it retained to deal with the Flexible Annuity contract itself. The Seventh Circuit held that:

> The Flexible Annuity is a guaranteed benefit policy because Home Life not only set fixed annual rates but also backed its promise with its full assets.

941 F.2d at 568. This is entirely consistent with the conclusion of the Seventh Circuit that, because of its annual declaration of dividend interest rates in advance, the Flexible Annuity "resembled nothing so much as a series of fixed annuities, each one year in duration, with the purchaser, having an option to renew." 941 F.2d at 567. Because the pension plans could withdraw their funds from the Flexible Annuity at any time, and because the accumulated amount plus the guaranteed return for the coming year were always known to the pension plans, the amount of benefits within Home Life's control was fully guaranteed at all times.

The Seventh Circuit's conclusion is not in conflict with the legislative history of ERISA. The original pension reform bills, H.R.2 introduced on January 3, 1973 and S.4, introduced on January 4, 1973, and passed by the House and Senate, were in general agreement that funds held by an insurance carrier in its general assets account would not be subject to ERISA fiduciary responsibilities. Sec-

tion 511 of the Senate bill specifically provided that fiduciary obligations would not apply to "funds" held by an insurance carrier unless that carrier holds funds in a separate account. The House bill did not contain a specific provision on this subject; however, a summary of the differences between the two bills prepared by the cooperating committee staffs, noted that the Senate bill attached no fiduciary duties to "funds held by an insurance carrier unless they are held in a separate account" and that "[a]lthough the House bill does not specifically exempt these funds from the fiduciary responsibility rules, the policy of the House bill is the same." Summary of Differences Between the Senate Version and the House Version of H.R.2, pt. 3, 94th Cong., 2d Sess. at 2 and n.3 (1974), *reprinted in* 3 Staff of Senate Comm. on Labor & Public Welfare, 94th Cong., 2d Sess. Legislative History of ERISA at 5252 (Comm. Print 1976). While the Seventh Circuit did not specifically analyze this history, its conclusion is entirely consistent with it.

The Seventh Circuit's conclusion is also consistent with early administrative interpretation by the Department of Labor concerning the meaning of the term "guaranteed benefit policy." The Department's position is that, if the trustee of a plan purchases an insurance policy or contract and the consideration is placed in the insurer's general asset account, the assets of the general account are not plan assets. Interpretive Bulletin 75-2 (Feb. 6, 1975), 29 C.F.R. §2509.75-2 (1984) ("I.B. 75-2"). I.B. 75-2 states,

> "if an insurance company issues a contract or policy of insurance to a plan and places the consideration for such contract or policy in its general asset account, the assets in such account shall not be considered to be plan assets."

This position was reaffirmed by the Labor Department on a number of more recent occasions. *See* 44 Fed. Reg. 46365, 46368 (Aug. 7, 1979); 44 Fed. Reg. 50363, 50364 n.4 (Aug. 28, 1979); 45 Fed. Reg. 51303, 51304, 51305 n.9 (Aug. 1, 1980); 46 Fed. Reg. 46443, 46444 (Sept. 18, 1981). This interpretation was accepted by the court in *Harris Trust and Savings Bank v. John Hancock Mutual Life Ins. Co.*, 722 F.Supp. 998, 1018-19 (S.D.N.Y., 1989) ("Harris Trust").

The *Harris Trust* court buttressed its conclusion by noting the fact that the Department of Labor had published a final regulation dealing with the definition of "plan assets." 51 Fed. Reg. 41280 (Nov. 13, 1986). 29 C.F.R. §2510.3-101. *Harris Trust* concluded that if, in regulating plan assets, the Department made no mention of insurance company general account contracts, and specifically left intact paragraph (b) of I.B. 75-2, the Department did so because, in its view, general account contracts such as the Flexible Annuity do not give an insurer control of plan assets. 722 F. Supp. at 1019.

The Seventh Circuit's holding is also consistent with the result reached by the trial court after it thoroughly analyzed these same plan asset regulations. The trial court began by noting that it was the intent of the regulation to look through the form of an entity to hold it directly liable as a fiduciary with respect to plan assets ostensibly used to purchase an equity interest in that enterprise. 729 F. Supp. at 1183. The court then noted the general rule stated in REG. §2510.3-101(a)(2), that a plan's acquisition of a non-equity interest in an entity will not give the plan a share of the *entity's* assets. 729 F. Supp. at 1185. The trial court then quickly and correctly concluded that a plan's possession of an ordinary participating insurance contract would be viewed as giving it a debt interest in the insurer under New York law, and that the plan asset

regulations would generally exempt Home Life from ERISA fiduciary duties. 729 F. Supp. at 1186. The court then reviewed the features of the Flexible Annuity which included both: a guarantee of the principal amount of contributions and credited interest; and excess interest rate at all times declared in advance of payment and for a specified period. The court concluded that, because of those guarantees, Home Life was the party which bore the risk of loss on the contributions made under the contract, and that therefore the FA was not the sort of defacto investment management that the look through rule of the plan asset regulations was designed to reach. 729 F. Supp. at 1188.

Finally, the Seventh Circuit's conclusion does not conflict with the Third Circuit's opinion in *Mack Boring & Parts v. Meeker Sharkey Moffit*, 930 F.2d 267 (3d Cir. 1991). Both the Third Circuit and the Seventh Circuit reached the same conclusion, namely, that the insurance policies involved in both cases were "guaranteed benefit policies." Petitioners make no effort to demonstrate that the Flexible Annuity and the insurance policy involved in *Mack Boring* are factually similar, and in fact they are not. Under those circumstances, the fact that the Seventh Circuit in the instant case used a different analysis to reach the same result as that of the Third Circuit in *Mack Boring* is not surprising, and certainly no conflict in the Circuits is created.

C.

THE ISSUES PRESENTED ARE NOT IMPORTANT BEYOND THE LITIGANTS TO THIS CASE.

The trial court properly granted, and the Seventh Circuit properly affirmed, summary judgment to the defendants. They did so by carefully analyzing and applying

existing law and concluding that when a pension plan purchases a traditional annuity contract, it buys neither a security nor creates ERISA fiduciary obligations with respect to the premiums paid to the insurer. Petitioners have not sought review of the Seventh Circuit's affirmance of the trial court's finding that no actionable fraud or misrepresentations occurred. Because this finding would sharply limit the scope of further proceedings on any remand, and because the Seventh Circuit's decision breaks no new legal ground and does not conflict with the decisions of this Court or those of other Circuits, the special and important reasons which would cause this Court to exercise its discretion and grant a full review in this case simply do not exist.

CONCLUSION

For the foregoing reasons, respondent, Home Life Insurance Company of New York, prays that this Court deny the petition for writ of certiorari to the United States Court of Appeals for the Seventh Circuit.

Respectfully submitted,

JOSEPH J. HASMAN
Counsel of Record
PETERSON & ROSS
200 East Randolph Drive
Chicago, Illinois 60601

Attorney for Respondent
HOME LIFE INSURANCE
COMPANY OF NEW YORK

Of Counsel:

ERNEST W. IRONS
PETERSON & ROSS
200 East Randolph Drive
Chicago, Illinois 60601